

MEMO# 32164

January 21, 2020

SEC Staff Issues Additional FAQs on Reg BI and Form CRS

[32164]

January 21, 2020 TO: ICI Members
Investment Company Directors
Broker/Dealer Advisory Committee
Investment Advisers Committee
Operations Committee
Pension Committee
SEC Rules Committee
Transfer Agent Advisory Committee SUBJECTS: Compliance
Disclosure
Investment Advisers
Operations RE: SEC Staff Issues Additional FAQs on Reg BI and Form CRS

The SEC staff recently issued additional “frequently asked questions” (FAQs) on Regulation Best Interest (“Reg BI”) and Form CRS, which were adopted last June as part of the SEC’s standards of conduct rulemakings.[\[1\]](#) The staff’s recent FAQs supplement the FAQs the staff issued last November.[\[2\]](#) The staff plans to update the FAQs periodically. While the recent FAQs do not have direct relevance to registered investment companies, we have summarized them briefly below, by topic, for your information.

“Recommendation”

The FAQs address which account recommendations are covered by Reg BI. The staff explains that Reg BI expressly applies to account recommendations including recommendations of different types of securities accounts (e.g., to open an IRA or other brokerage account, or an advisory account) and recommendations to roll over or transfer assets from one account to another (e.g., rollover from a workplace retirement plan to an IRA account). The staff gives examples of the many different options and account types within brokerage accounts and reminds broker-dealers that the term “investment strategy,” which includes account recommendations, will be interpreted broadly. Account recommendations will almost always involve a securities transaction, and thus, would generally be subject to Reg BI.

The FAQs address how Reg BI applies to individuals and firms that are dually registered as broker-dealers and investment advisers. The staff explains that dually registered financial professionals, when making account recommendations, must take into consideration the

full spectrum of accounts they offer and not limit consideration to just brokerage accounts. The staff further clarifies that if an individual is only registered as an associated person of a broker-dealer, but the firm is dually registered, that individual would only need to take into consideration the brokerage accounts available at the firm.[\[3\]](#)

The FAQs also address when communications made in informal settings will be treated as recommendations for purposes of both Reg BI and Form CRS, and clarifies that the term “recommendation” will be interpreted in the same manner for purposes of Reg BI and Form CRS.[\[4\]](#) The staff explains that, if a broker-dealer engages in a communication with a retail customer that rises to the level of a recommendation, it will be treated as a recommendation, regardless of whether the conversation is a casual discussion promoting the broker-dealer’s services (sometimes referred to as a “hire me” communication). The staff clarifies, however, that not all communications with a retail customer will rise to the level of a recommendation. For example, informing existing customers that a broker-dealer representative has switched firms (without information about the new firm’s offerings) and general investment education (e.g., a general conversation with a retail customer about retirement planning, informing a retail customer about the need to take a required minimum distribution under the Internal Revenue Code).

Reg BI’s Disclosure Obligation

The FAQs explain that only in limited circumstances can an associated person of a broker-dealer satisfy Reg BI’s requirement to provide written disclosures, prior to or at the time of a recommendation, by providing oral disclosures or providing written disclosures after a recommendation has been made. The staff notes that the SEC provided flexibility with respect to the “in writing” requirement of Reg BI’s Disclosure Obligation, as well as with respect to the timing that disclosure must be made, in certain circumstances, such as updating written disclosures orally to reflect facts not reasonably known at the time the written disclosure was provided. The FAQs also confirm that broker-dealers generally cannot satisfy Reg BI’s Disclosure Obligation solely by means of Form CRS. Whether Form CRS or any existing disclosure by itself will satisfy the Disclosure Obligation will depend on the facts and circumstances, but in most instances, the staff believes additional information will need to be provided.

The staff includes a couple of FAQs that address disclosure delivery obligations. One FAQ confirms that Reg BI and Form CRS permit firms to provide electronic delivery of documents, consistent with existing SEC guidance on electronic delivery. The staff clarifies that firms may deliver an initial Form CRS to a new or prospective client or customer in the same manner that the investor requested information about the firm or its financial professional, but that this approach may not be used to satisfy the Reg BI Disclosure Obligation.

The staff also confirms that, similar to its prior FAQ on Form CRS delivery, a broker-dealer may include, in a quarterly mailing after June 30, 2020, information to satisfy Reg BI’s Disclosure Obligation. That mailing, however, will not satisfy the Disclosure Obligation with respect to any recommendations made to retail customers between June 30, 2020 and when those Reg BI disclosures are provided.

Reg BI’s Care Obligation

The FAQs address what constitutes a “series of recommended transactions,” for purposes of Reg BI’s Care Obligation.[\[5\]](#) The staff references the existing definition of “series” under the federal securities laws and SRO rules. The staff notes that the regulation does not

change this well-established definition. What constitutes a “series” of recommended transactions will depend on the facts and circumstances specific to each retail customer.

Reg BI’s Conflict of Interest Obligation

The staff confirms in the FAQs that Reg BI does not require particular mitigation methods, noting that the Commission recognized that there are a variety of incentives and, depending on the specific characteristics of an incentive, different levels and types of mitigation may be necessary. In lieu of mandating specific mitigation measures, broker-dealers have flexibility to develop and tailor reasonably designed policies and procedures that include conflict mitigation measures based on each firm’s circumstances. The FAQs include the list of non-exhaustive conflict mitigation methods from the Reg BI adopting release and note specifically that the Commission did not require firms to establish differential compensation based on neutral factors, but that doing so is one potential practice to comply with Reg BI’s Conflict Obligation.

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endnotes

[1] The FAQs, which were prepared by the staffs of the SEC’s Divisions of Investment Management and Trading and Markets, are *available at* <https://www.sec.gov/tm/faq-regulation-best-interest>; <https://www.sec.gov/investment/form-crs-faq#delivery>. For a detailed summary of the SEC’s rulemakings, *please see* the attachments to ICI Memorandum No. 31815 (June 19, 2019), *available at* https://www.ici.org/my_ici/memorandum/memo31815.

[2] For a summary of the November FAQs, *please see* ICI Memorandum No. 32068 (Nov. 27, 2019), *available at* https://www.ici.org/my_ici/memorandum/memo32068.

[3] The staff notes, however, that even if the firm only offers brokerage accounts, the associated person still must have a reasonable basis to believe the recommendation is in the retail customer’s best interest.

[4] The SEC will interpret the term “recommendation” consistent with precedent under the anti-fraud provisions of the federal securities laws as applied to broker-dealers, and with how the term has been applied under the rules of self-regulatory organizations (SROs). The staff notes that, under the existing framework, a key factor is whether the communication “reasonably could be viewed as a ‘call to action.’” A communication is more likely to be deemed a “recommendation” the more it is individually tailored to a specific customer or group of customers.

[5] Reg BI’s Care Obligation requires that a broker-dealer, in making a recommendation, exercise reasonable diligence, care, and skill to, among other things, have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer’s best interest when viewed in isolation, is not excessive and is in the retail customer’s best

interest when taken together in light of the retail customer's investment profile and does not place the financial or other interest of the broker-dealer ahead of the customer's interest.

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